

CONFORMED COPY

CREDIT NUMBER 3959 KE

Development Credit Agreement

(Micro, Small and Medium Enterprise Competitiveness Project)

between

REPUBLIC OF KENYA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated August 4, 2004

CREDIT NUMBER 3959 KE

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT, dated August 4 ,2004, between REPUBLIC OF KENYA (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Association to assist in the financing of the Project; and

(B) the Association has agreed, on the basis, inter alia, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Development Credit Agreements” of the Association, dated January 1, 1985 (as amended through October 6, 1999) (the General Conditions), constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “BDS Grant” means a business development service grant to be made out of the proceeds of the Credit for the provision of technical advisory services or training for MSME Consortium (as hereinafter defined) under Part B.1 of the Project, and in its plural form the term means more than one such Grant;

(b) “BDS Grant Agreement” means an agreement to be entered into between the BDS Manager (as hereinafter defined) and a MSME Consortium as specified in the BDS Grants Manual (as hereinafter defined) for the provision of a BDS Grant in accordance with the provisions of Section IV of Schedule 4 to this Agreement, and in its plural form the term means more than one such Agreement;

(c) “BDS Grants Manual” means the manual to be prepared by the Borrower for the provision of BDS Grants and referred to in Section 5.01 (b) and Section IV of Schedule 4 to this Agreement;

(d) “BDS Manager” means a private sector firm to be recruited in the accordance provisions of Section IV.2 of Schedule 4 to this Agreement to assist the Borrower in managing the provision of BDS Grants;

(e) “CB Grant” means a Capacity Building Grant to be made or proposed to be made under Part A.1 of the Project to qualifying providers of financial services out of the proceeds of the Credit under terms and conditions set forth in the CBGM (as this term is hereinafter defined), and in its plural form the term means more than one such Grant;

(f) “CB Grant Agreement” means a Capacity Building Grant Agreement” to be entered into between the Trust (as hereinafter defined) and a MFI (as hereinafter defined) or a CFI (as hereinafter defined) for the provision of a CB Grant in accordance with the provisions of Section II.1 of Schedule 4 to this Agreement and in its plural form the term means more than one such Agreement;

(g) “CBGM” means the Capacity Building Grants Manual to be adopted by the Borrower for the provision of CB Grants and referred to in Section 5.01 (c) and Section II.1 of Schedule 4 to this Agreement;

(h) “CFI” means a commercial financial institution such as banks established and operating in accordance with the Borrower’s laws;

(i) “Eligible Categories” means Categories (1) to (6) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

(j) “Eligible Expenditures” means the expenditures for goods and consultants’ services referred to in Section 2.02 of this Agreement;

(k) “Financial Sector Deepening Trust” means the trust fund incorporated under the laws of the Borrower to administer CB Grants;

(l) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 4.02 of this Agreement.

(m) “Fund” means the Risk Capital Fund defined in Paragraph (ff) of this Section;

(n) “Fund Manager” means a private sector firm which meets the Risk Capital eligibility criteria set forth in PIP, and in its plural form the term means more than one Fund Manager;

(o) “Grants” means BDS Grant, CB Grant and Risk Capital Grant, and in its singular form the term means any one of such Grants;

(p) “Grant Agreements” means BDS Grant Agreement, CB Grant Agreement and Risk Capital Grant Agreement (as hereinafter defined), and in its singular form the term means any one of such Agreements;

(q) “Initial Deposit” means the initial amount to be deposited into the Project Account (as hereinafter defined) and referred to in Section 3.03 (b)(i) of this Agreement;

(r) “Kenya Private Sector Alliance” means the business association established and operating in accordance with the Borrower’s law and including as its members business associations operating in the Borrower’s territory;

(s) “Kenya Shilling” or “KES” means the currency of the Borrower;

(t) “Management Services Agreement” means the agreement to be entered into between the Borrower and the Project Management Contractor (as hereinafter defined) for the carrying out of financial management and procurement aspects of the Project and referred to in Section I.1 of Schedule 4 to this Agreement;

(u) “MFI” means a micro finance institution such as registered micro finance banks and nongovernmental organizations engaged in the delivery of financial services to the MSME sector, including Savings and Credit Cooperatives (SACCOs) and non-banking financial institutions, established and operating in accordance with the Borrower’s laws;

(v) “MSME” means a micro, small and medium enterprise established and operating in the Borrower’s territory, and in its plural form the term means more than one MSME;

(w) “MSME Consortium” means a group of MSMEs applying together for a BDS Grant;

(x) “Operating Accounts” means the account to be opened by the Borrower to receive deposits in Kenya Shilling from the Special Account (as hereinafter defined) and referred to in Part C.1 of Schedule 1 to this Agreement;

(y) “Project Account” means the account referred to in Section 3.03 of this Agreement;

(z) “Participating MSME” means a MSME that receives support under the Project, and in its plural form the term means more than one MSME;

(aa) “PIP” or “Project Implementation Plan” means the plan to be prepared by the Borrower for the implementation of the Project and referred to in Section I.1 of Schedule 4 to this Agreement;

(bb) “PMC” or “Project Management Contractor” means a private sector firm to be recruited in accordance with the provisions of Section I of Schedule 4 to this Agreement to carry out, *inter alia*, financial management and procurement aspects of the Project and referred to in Section I.1 of Schedule 4 to this Agreement;

(cc) “Project Secretariat” means the Secretariat to be established by the Borrower to provide technical and policy advice to the Project Steering Committee (as hereinafter defined) for the implementation of the Project and referred to in Section I.2 of Schedule 4 to this Agreement;

(dd) “Project Steering Committee” means the committee to be established by the Borrower to, *inter alia*, provide overall guidance for the implementation of the Project and referred to in Section I.2 of Schedule 4 to this Agreement;

(ee) “Report-based Disbursements” means the Borrower’s option for withdrawal of funds from the Credit Account referred to in Part A.6 of Schedule 1 to this Agreement;

(ff) “Risk Capital Fund” means the fund to be established by private investors and incorporated in accordance with the Borrower’s laws to provide loans and quasi-equity to small and medium enterprises;

(gg) “Risk Capital Grant” means a Grant made to the Fund Managers under Part A.2 of Schedule 2 to this Agreement;

(hh) “Risk Capital Grant Agreement” means an agreement between the Borrower and a Fund Manager for the provision of a Grant to the Fund;

(ii) “RCGM” means the Risk Capital Grant Manual to be adopted by the Borrower for the provision of Risk Capital Grants and referred to Section II.1 of Schedule 4 to this Agreement; and

(jj) “Special Account” means the account referred to in Part B.1 of Schedule 1 to this Agreement;

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to fifteen million Special Drawing Rights (SDR 15,000,000).

Section 2.02. The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for: (i)

expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods and services required for the Project and to be financed out of the proceeds of the Credit; and (ii) amounts paid (or, if the Association shall so agree, to be paid) by the Borrower on account of withdrawals made under BDS Grants, CB Grants or Risk Capital Grants to meet the reasonable cost of goods, works and services to be financed under Parts A, B.1 and B.3 of the Project, in respect of which the withdrawal from the Credit Account is requested.

Section 2.03. The Closing Date shall be June 30, 2010 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on March 15 and September 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each March 15 and September 15 commencing September 15, 2014 and ending March 15, 2044. Each installment to and including the installment payable on March 15, 2024 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States of America is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the

Project through its Ministry of Trade and Industry with due diligence and efficiency and in conformity with appropriate financial, administrative and managerial practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Borrower and the Association shall otherwise agree, the Borrower shall carry out the Project in accordance with the Implementation Program set forth in Schedule 4 to this Agreement.

Section 3.02. (a) Except as the Association shall otherwise agree, procurement of the goods and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement, as said provisions may be further elaborated in the Procurement Plan.

(b) The Borrower shall update the Procurement Plan in accordance with terms of reference acceptable to the Association, and furnish such update to the Association not later than 12 months after the date of the preceding Procurement Plan, for the Association's approval.

Section 3.03. Without limitation upon the provisions of paragraph (a) of Section 3.01 of this Agreement, and except as the Borrower and the Association shall otherwise agree, the Borrower shall:

(a) open an account in Kenya Shilling in a commercial bank acceptable to the Association (the Project Account), and thereafter maintain the Project Account under terms and conditions acceptable to the Association until the completion of the Project;

(b) deposit into the Project Account: (i) an initial amount of one million one hundred thousand Kenya Shillings (KES 1,100,000) (the Initial Deposit); and (ii) thereafter, at quarterly intervals, replenish the Project Account by the amounts required to finance the Borrower's contribution for expenditures under the Project other than those financed from the proceeds of the Credit, as shall be agreed upon between the Borrower and the Association; and

(c) ensure that funds deposited into the Project Account in accordance with paragraph (b) of this Section shall be used exclusively to finance expenditures under the Project other than those financed from the proceeds of the Financing.

Section 3.04. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, a plan designed to ensure the continued achievement of the Project's objectives; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall cause the PMC to establish and maintain a financial management system, including records and accounts, and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall cause the PMC to:

- (i) have the financial statements referred to in paragraph (a) of this Section and the record and accounts for the Special Account and the Operating Account for each fiscal year (or other period agreed to by the Association), audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association;
- (ii) furnish to the Association as soon as available, but in any case not later than six months after the end of each such year (or such other period agreed to by the Association), (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Association), as so audited, and (B) an opinion on such statements, records and accounts by said auditors, in scope and detail satisfactory to the Association; and
- (iii) furnish to the Association such other information concerning such records and accounts, and the audit of such financial statements, record and accounts and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of reports referred to in Part A.6 of Schedule 1 to this Agreement (Report-based Disbursements) or on the basis of statements of expenditure, the Borrower shall cause the PMC to:

- (i) retain, until at least one year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Credit Account was made, all records

(contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;

- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such reports and statements of expenditure are included in the audit for each fiscal year (or other period agreed to by the Association), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in Section V of Schedule 4 to this Agreement, the Borrower shall cause the PMC to prepare and furnish to the Association a financial monitoring report, in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation ; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than 45 days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Effective Date; Termination

Section 5.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions :

- (a) the Borrower has prepared and furnished to the Association a PIP in form and substance satisfactory to the Association;

(b) the Borrower has prepared and furnished to the Association a BDS Grants Manual in form and substance satisfactory to the Association;

(c) the Borrower has adopted and furnished to the Association a CBGM in form and substance satisfactory to the Association;

(d) the Borrower has established the Project Steering Committee satisfactory to the Association;

(e) the Borrower has established the Project Secretariat satisfactory to the Association;

(f) the Borrower has entered into the Management Services Agreement with the PMC in form and substance satisfactory to the Association;

(g) the Borrower has opened the Special Account;

(h) the Borrower has opened the Project Account and has deposited therein the Initial Deposit referred to in Section 3.03 of this Agreement; and

(i) selection of Fund Managers under Part A.2 of Schedule 2 to this Agreement has been completed in accordance with the criteria and procedures satisfactory to the Association.

Section 5.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VI

Representative of the Borrower; Addresses

Section 6.01. The Borrower's Minister for Finance is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 6.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
Treasury Building
P.O Box 30007-00100
Nairobi, Kenya

Cable address:	Telex:	Facsimile:
FINANCEnairobi	22921minfin-ke	+ (254) 20 330426

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:	Telex:	Facsimile:
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in Nairobi, Kenya, as of the day and year first above written.

REPUBLIC OF KENYA

By /s/ David Mwiraria
Authorized Representative

INTERNATIONAL DEVELOPMENT
ASSOCIATION

By /s/ Makhtar Diop
Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Goods	210,000	100% of foreign expenditures, and 90% of local expenditures
(2) Consultants' services including audit fees	4,890,000	100% of foreign expenditures, and 94% of local expenditures
(3) Workshops and training	350,000	100%
(4) CB Grants under Part A.1 of the Project	2,730,000	100% of amounts disbursed
(5) Risk Capital Grants under Part A.2 of the Project	4,430,000	100% of amounts disbursed
(6) BDS Grants under Part B.1 of the Project	2,060,000	100% of amounts disbursed
(7) Unallocated	330,000	
TOTAL	<u>15,000,000</u>	

2. For the purposes of this Schedule:

(a) the term “foreign expenditures” means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower; and

(b) the term “local expenditures” means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower.

3. It is understood that the percentages of expenditures to be financed under the table set forth in paragraph 1 of this Schedule have been calculated on the basis of the provision of a letter issued by the Borrower’s Ministry of Finance pursuant to Section 138 (1) and (2) (g) of The Customs and Excise Act and Section 23 (1) and 3 (e) of the VAT Act, as read together with the Legal Notice Number 138 (The Customs and Excise Act, Chapter 472) and Legal Notice No. 145 (VAT Act, Chapter 476) both of 4th June, 1992 (as amended in 1996 and 2001) of the Borrower, which provides for exemption of taxes levied in the territory of the Borrower on works, goods and services for this Project. If any change is made to said Letter and Acts or Legal Notices, which has the effect of levying taxes or customs duties on such works, goods and services, the percentages referred to above shall be decreased in accordance with the provisions of Section 5.08 of the General Conditions.

4. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of: (a) payments made for expenditures prior to the date of this Agreement; and (b) Grants from Categories 4, 5 and 6 until the relevant Grant Agreement has been signed .

5. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) goods costing less than \$150,000 equivalent per contract; (b) for services of individual consultants costing less than \$50,000 equivalent per contract; (c) for services of consulting firms under contracts costing less than \$100,000 equivalent per contract; (d) workshops and training; and (e) BDS Grants, CB Grants and Risk Capital Grants, all under such terms and conditions as the Association shall specify by notice to the Borrower.

6. The Borrower may request withdrawals from the Credit Account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include the FMR and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Association before any withdrawal has been made from the Credit Account, the Borrower shall submit to the Association only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Account

1. The Borrower may open and maintain in Dollars a special deposit account in a commercial Bank acceptable to the Association, on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure and attachment.

2. After the Association has received evidence satisfactory to it that the Special Account has been opened, withdrawals from the Credit Account of amounts to be deposited into the Special Account shall be made as follows:

(a) if the Borrower is not making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) if the Borrower is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

3. Payments out of the Special Account shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

4. Notwithstanding the provisions of Part B.2 of this Schedule, the Association shall not be required to make further deposits into the Special Account:

(a) if the Association, at any time, is not satisfied that the reports referred to in Part A.4 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

(b) if the Association determines at any time that all further withdrawals for payment of Eligible Expenditures should be made by the Borrower directly from the Credit Account; or

(c) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of: (A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

5. The Association shall not be required to make further deposits into the Special Account in accordance with the provisions of Part B.2 of this Schedule if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to Section 6.02 of the General Conditions. Upon such notification, the Association shall

determine, in its sole discretion, whether further deposits into the Special Account may be made and what procedures should be followed for making such deposits, and shall notify the Borrower of its determination.

6. (a) If the Association determines at any time that any payment out of the Special Account was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association, provide such additional evidence as the Association may request, or deposit into the Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association determines at any time that any amount outstanding in the Special Account will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Account.

(d) Refunds to the Association made pursuant to subparagraph (a), (b) or (c) of this paragraph 6 shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the provisions of the Credit Agreement.

C. Operating Account

1. The Borrower shall open and maintain in Kenya Shilling an Operating Account, in one or more commercial banks, on terms and conditions satisfactory to the Association (including appropriate protection against set-off, seizure or attachment).

2. The Borrower shall, in accordance with procedures acceptable to the Association, withdraw from time to time from the Special Account and deposit into the Operating Account, an amount required to finance eligible expenditures for a period of 90 days of Project implementation.

3. Payments out of the Operating Account shall only be made for eligible expenditures.

4. In the event that the Association, after consultation with the Borrower, determines that any outstanding amount in the Operating Account is not further required to cover payments for Eligible Expenditures, the Borrower, upon notice from the Association shall promptly refund such outstanding amount to the Special Account.

Annex A

to

SCHEDULE 1

**Operation of Special Account
When Withdrawals Are Not
Report-based Disbursements**

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of one million five hundred thousand dollars (\$1,500,000) to be withdrawn from the Credit Account and deposited into the Special Account pursuant to paragraph 2 of this Annex.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account of an amount or amounts which in the aggregate do not exceed the Authorized Allocation. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested.

(b) For replenishment of the Special Account, the Borrower shall furnish to the Association requests for deposit into the Special Account at such intervals as the Association shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to Part B.3 of Schedule 1 to this Agreement for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account for Eligible Expenditures. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

3. The Association shall not be required to make further deposits into the Special Account, once the total unwithdrawn amount of the Credit minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts

remaining on deposit in the Special Account as of the date of such notice will be utilized in making payments for Eligible Expenditures.

Annex B

to

SCHEDULE 1

**Operation of Special Account
When Withdrawals Are
Report-based Disbursements**

1. Withdrawals from the Credit Account shall be deposited by the Association into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the Special Account shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

2. Upon receipt of each application for withdrawal of an amount of the Credit, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Association has determined, based on the reports referred to in Part A.4 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.

SCHEDULE 2

Description of the Project

The objectives of the Project are to increase productivity and employment in participating MSMEs through facilitation of access to finance; strengthening employable skills and market linkages; and improvement of investment climate.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

Part A: Access to Finance

1. Improvement, provision and expansion of financial services to MSMEs through CB Grants, including: (a) assistance to MFIs in introducing new systems and methodologies of individual lending products, expanding MFIs outreach to underserved areas and improving MFIs operations, management, and governance structure; and (b) assistance to CFIs in building capacity and introducing new products to expand their financial services to MSMEs.
2. Financial assistance to Fund Managers through Risk Capital Grants: (a) as a partial support for management arrangements; and (b) provision of TA to the Fund's MSME beneficiaries.

Part B: Strengthening MSMEs Employable Skills and Market Linkages

1. Provision of training and business development services to strengthen competitiveness and performance at critical points in supply chains through provision of BDS Grants.
2. Restructuring of the existing industrial training levy scheme based on clearly defined strategic objectives, and assessment of skills needs.
3. (a) Strengthening the capacity of the Borrower's universities' business schools to: (i) develop locally relevant study cases and integrate these cases into existing curriculum; and (ii) expand their curriculum to include training for MSMEs in the form of short courses; and (b) facilitation of a national business plan competition to promote innovative business ideas, all through provision of technical advisory services and training .

Part C: Business Environment

1. Implementation of a pilot program aimed at reducing the cost and time of compliance with business regulations through provision of technical advisory services

and acquisition of equipment to combine various existing procedures into one interface for business start up.

2. Development and launch of a simplified taxation system for micro and small businesses.

* * *

The Project is expected to be completed by December 31, 2009.

SCHEDULE 3

Procurement

Section I. General

A. All goods and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Procurement Guidelines), and with the provisions of this Schedule.

B. All consultants' services shall be procured in accordance with Section I, paragraphs 3.15 through 3.20, and Section IV of, and Appendix 2 to, the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004 (the Consultant Guidelines), and with the provisions of this Schedule.

Section II. Particular Methods of Procurement of Goods and Services (other than Consultants' Services)

A. International Competitive Bidding. Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of international competitive bidding in accordance with the provisions of Section II of the Procurement Guidelines, and the following additional procedures:

1. Domestic Preference. The provisions of paragraphs 2.55 and 2.56 of the Procurement Guidelines and Appendix 2 thereto, providing for domestic preference in the evaluation of bids, shall apply to goods manufactured in the territory of the Borrower.

B. Other Procurement Procedures

1. National Competitive Bidding. Goods estimated to cost less than \$150,000 equivalent per contract, may be procured under contracts awarded on the basis of national competitive bidding in accordance with the provisions of paragraphs 3.1, 3.3, 3.4, of the Procurement Guidelines.

2. Shopping. Goods estimated to cost less than \$30,000 equivalent per contract, may be procured under contracts awarded on the basis of shopping procedures in accordance with the provisions of paragraphs 3.1 and 3.5 of the Guidelines.

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality- and Cost-based Selection.

1. Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of quality and cost in accordance with the provisions of Section II of the Consultant Guidelines. For purposes of paragraph 2.7

of the Consultant Guidelines, the short list of consultants for services estimated to cost less than \$100,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

1. Quality-based Selection. Services for assignments which the Association agrees meet the requirements set forth in paragraph 3.2 of the Consultant Guidelines may be procured under contracts awarded on the basis of Quality-based Selection in accordance with the provisions of paragraphs 3.1 through 3.4 of the Consultant Guidelines.

2. Single Source Selection. Services for tasks in circumstances which meet the requirements of paragraph 3.10 of the Consultant Guidelines for single source selection, may, with the Association's prior agreement, be procured in accordance with the provisions of paragraphs 3.9 through 3.13 of the Consultant Guidelines.

3. Individual Consultants. Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines.

4. Selection Based on Consultants' Qualifications. Services for training and workshops may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

Section IV. Review by the Association of Procurement Decisions

A. Prior Review

The following review procedures shall apply to contracts for which the Procurement Plan provides for prior review by the Association:

1. Goods and Services (other than Consultants' Services).

The prior review procedures set forth in paragraphs 2, 3 and 5 of Appendix 1 to the Procurement Guidelines shall apply to each contract for goods and services (other than consultants' services) estimated to cost the equivalent of \$150,000 or more per contract.

2. Consultants' Services Provided by Firms.

The prior review procedures set forth in paragraphs 2, 3 and 5 of Appendix 1 to the Consultant Guidelines shall apply to contracts for consultants' services provided by firms estimated to cost \$100,000 equivalent per contract . However, if such contracts are to be procured on the basis of single source selection, the following procedures shall apply instead: (a) the qualifications, experience, terms of reference and conditions of employment of the consultants shall be furnished to the Association for its prior review

and approval; (b) the contract shall be awarded only after the Association's approval shall have been given; and (c) the provisions of paragraphs 3 and 5 of Appendix 1 to the Consultant Guidelines shall apply to the contract.

3. Consultants' Services Provided by Individuals.

The following prior review procedures shall apply to contracts for the employment of individual consultants estimated to cost \$ 50,000 per contract: (a) the report on the comparison of the qualifications and experience of candidates, terms of reference and terms of employment of the consultants (or, if the consultant is to be selected on a sole source basis, the qualifications, experience, terms of reference and terms of employment of the consultants) shall be furnished to the Association for its prior review and approval; (b) the contract shall be awarded only after the Association's approval shall have been given; and (c) the provisions of paragraph 3 and 5 of Appendix 1 to the Consultant Guidelines shall apply to the contract.

B. Post Review.

The following post review procedures shall apply to all contracts for which the Procurement Plan does not provide for prior review by the Association:

1. With respect to contracts for goods or services (other than consultants' services), the post review procedures set forth in paragraph 4 of Appendix 1 to the Procurement Guidelines shall apply.
2. With respect to contracts for consultants' services, the post review procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 4

Implementation Program

Section I. Project Implementation and Management

1. The Borrower shall:

(a) Carry out the Project through its Ministry of Trade and Industry in accordance with the requirements of PIP, and, except as the Association shall otherwise agree, not amend or waive any provision thereof which, in the opinion of the Association, may adversely and materially affect the implementation of the Project; and

(b) Enter into a Management Services Agreement with a Project Management Contractor under terms and conditions satisfactory to the Association, including, *inter alia*, the obligation of the private sector firm to: (i) support the Borrower in carrying out general administration and implementation support, financial management, disbursement and procurement; and (ii) comply with those obligations referred to in Sections 4.01 and 4.02 of this Agreement.

2. For overall Project oversight, the Borrower shall maintain, at all times during implementation of the Project, the Project Steering Committee and the Project Secretariat, with their composition, terms of reference and staffing satisfactory to the Association.

3. The Borrower shall carry out all training and workshops under the Project on the basis of programs, which shall have been approved by the Association on a quarterly basis, and which shall, *inter alia*, identify: (a) the training and workshops envisaged; (b) the personnel to be trained; (c) the institutions which will conduct the training; (d) the duration of the proposed training; and (e) an estimate of the cost.

Section II. Procedures and Eligibility Criteria for CB Grants

1. The CBGM shall, *inter alia*, set out details of: (a) the activities to be financed by CB Grants, beneficiaries and eligibility criteria for receiving such Grants; (b) arrangements and procedures for preparation, appraisal, approval, implementation and supervision of activities to be financed by CB Grants; (c) procurement, financial management and disbursement arrangements; (d) performance indicators; (e) standard formats for CB Grant Agreements; and (f) such other administrative, financial and organizational arrangements as shall be required for providing CB Grants.

2. The Borrower shall enter into an agreement with the Financial Sector Deepening Trust (the Trust) in form and substance satisfactory to the Association including, *inter alia*, the obligations of the Trust to manage and provide CB Grants under Part A.1 of the Project in accordance with procedures and eligibility criteria set forth in the PIP and the CBGM.

3. To provide a CB Grant, the Borrower shall cause the Trust to enter into a CB Grant Agreement with the beneficiary financial institution qualified to receive a CB Grant in accordance with the eligibility criteria laid down in the CBGM.

Section III. Procedures and Eligibility Criteria for Risk Capital Grants

1. The Borrower shall adopt RCGM satisfactory to the Association. It shall, *inter alia*, set out details of: (a) the activities to be financed by the Risk Capital Grants, beneficiaries and eligibility criteria for such Grants; (b) arrangements and procedures for preparation, appraisal, approval, implementation and supervision of activities to be financed by the Risk Capital Grants; (c) procurement, financial management and disbursement arrangements; (d) performance indicators; (e) standard formats for the Risk Capital Grant Agreements; and (f) such other administrative, financial and organizational arrangements as shall be required for providing the Risk Capital Grants.

2. The Borrower shall enter into an agreement with the selected Fund Managers in form and substance satisfactory to the Association including, *inter alia*, the obligations of the Fund to: (a) manage and provide technical assistance (TA) under Part A.2 (b) of the Project in accordance with procedures and eligibility criteria set forth in the PIP and the RCGM; and (b) provide TA only to MSMEs.

Section IV. Procedures and Eligibility Criteria for BDS Grants

1. The BDS Grants Manual shall, *inter alia*, set out details of: (a) BDS Grants, activities to be financed by BDS Grants, beneficiaries and eligibility criteria; (b) arrangements and procedures for preparation, appraisal, approval, implementation and supervision of activities to be financed by BDS Grants; (c) procurement, financial management and disbursement arrangements; (d) performance indicators; (e) standard formats for BDS Grant Agreements; and (f) such other administrative, financial and organizational arrangements as shall be required for providing BDS Grants.

2. The Borrower shall enter into an agreement with the BDS Manager in form and substance satisfactory to the Association including, *inter alia*, the obligations of the BDS Manager to: (a) manage and provide BDS Grants under Part B.1 of the Project in accordance with procedures and eligibility criteria set forth in the PIP and the BDS Grants Manual; and (b) provide BDS Grants only to an MSME Consortium.

3. To provide a BDS Grant, the Borrower shall cause the BDS Manager to enter into a BDS Grant Agreement with the beneficiary MSME Consortium which shall include, but not be limited to the following:

(a) the MSME Consortium shall contribute investments equivalent to the total cost of the amounts provided by the BDS Grants, and the BDS Grant shall not exceed the equivalent of one hundred fifty thousand dollars (\$150,000);

(b) MSME's Consortium obligation to carry out the activities to be financed by the BDS Grant in accordance with the BDS Grants Manual, with due diligence and efficiency and in accordance with sound technical, financial and managerial standards and to maintain adequate records to reflect, in accordance with sound accounting practices, the operations, resources and expenditures in respect of the BDS Grant;

(c) the requirement that: (i) services to be financed from the proceeds of the BDS Grant shall be procured in accordance with the procedures set forth in BDS Grants Manual, and (ii) such services shall be used exclusively in the carrying out of the eligible activities in accordance with the BDS Grant Manual.

Section V. Monitoring and Evaluation

16. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators set forth in Schedule 5 to this Agreement, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about December 31, 2006, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(c) review with the Association, by February 28, 2007, or such later date as the Association shall request, the report referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association's views on the matter.

17. Annual Reports. The Borrower shall submit to the Association annual reports, in scope and form agreed with the association, for the Project not later than three months after the completion of the fiscal year of the Borrower.

SCHEDULE 5

Performance Indicators

The performance indicators for the Project shall include the following, said indicators being subject to modifications by agreement between the Borrower and the Association:

1. At least 2,500 new jobs created in participating MSMEs.
2. Value added efficiency per worker increased by 20% in participating MSMEs.
3. 70% of MFIs and CFIs receiving Finance Grants meet or exceed their business plan targets for MSMEs outreach and portfolio quality.
4. \$11,500,000 in loans and quasi-equity investments to MSMEs disbursed through the Risk Management Fund with loan loss rate below 10%.
5. A comprehensive supply chain strategy, which responds to the market, technical, human resource and financial needs of key players along the entire supply chain is created for at least three strategic sectors.
6. Increased subcontracting in supported supply chains, providing at least 50% increase in the level of local sourcing.
7. Agreement on training levy scheme, legislation and implementation plan.
8. 100 new business case studies introduced into the Borrower's universities' business schools curriculum.
9. Case-based instruction is routinely used in at least one required course in each of the participating business schools.
10. At least 200 eligible entrepreneurs apply to business plan competition in first year of Project implementation , with at least 5% increase in number of eligible applicants annually.
11. Number of formally registered MSMEs is increased by at least 25%.
12. Average cost of complying with business start-up regulations is reduced to no more than \$100 and time required is reduced to no more than two weeks.
13. Number of MSMEs that participate in the business tax increases by at least 15%.